Cheatography

Market Failure & Government Policies Cheat Sheet

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Market Failure

where the free market does not make the best use of scarce resources.

- where the outcomes of a free market differ from the socially optimal outcomes.

When does 'Market Failure' occur?

occurs when the free market fails to efficiently allocate goods and services.

Reasons for Market Failure

1. Externalities
2. Public Goods
3. Asymmetric Information
4. Abuse of Market Power

Externalities

1. Positive Externality	where the side effects have a positive impact and provide benefits to third parties.
2. Negative Externality	where the side effects have a negative impact and impose costs to third parties.

Reasons of Market Failure: Externalities

MSC (marginal social cost) is above the MPC (marginal private cost).

- MPC is the Supply Curve and DD is the demand curve

Equilibrium: Supply = Demand

Social Optimum output level is achieved at Q’ where MSC = DD = MSB

SC of Production & SB of Consumption

Social Cost (SC) of Production

SC =	Private cost incurred by the firm (PC)+ Externalities

Social Benefit (SB) of Consumption

SB =	Private benefit enjoyed by consumers+ Externalities